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No. 620

IN THE

Supreme Court of the United States

OCTOBER TERM, 1943

INTERNATIONAL HARVESTER COMPANY,
Appellant,

vs.

WISCONSIN DEPARTMENT OF TAXATION,
Appellee.

ON APPEAL FROM THE SUPREME COURT OF WISCONSIN

APPELLANT'S BRIEF

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IN THE

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Appellee.

ON APPEAL FROM THE SUPREME COURT OF WISCONSIN

APPELLANT'S BRIEF

The case below is reported in 243 Wis., 198; 10 N. W. (2d), 169. Decision on rehearing is not yet printed in official Wisconsin Reports, but appears in 11 N. W. (2d), 95.

Grounds on Which This Court's Jurisdiction is Invoked

The jurisdiction of this Court is invoked under Section 237 of the Judicial Code, to review a final judgment of the Supreme Court of Wisconsin which affirmed a tax under the Wisconsin Privilege Dividend Tax Act (Sec. 3 of Chap. 505, Laws of 1935,

as amended), and sustained the validity of that law as applied to Appellant, a foreign corporation licensed to do business in Wisconsin, and to its stockholders, 98% of whom were not residents of Wisconsin. The tax in question was challenged and the validity of the law as applied to Appellant and its stockholders was drawn in question, upon the grounds that the law, and the tax purported to have been imposed thereunder, deprived Appellant and its stockholders of property without due process of law contrary to the provisions of the Fourteenth Amendment of the Constitution of the United States.

Statement of the Case

The tax affirmed by the judgment of the Wisconsin Supreme Court and involved on this appeal was imposed under the Wisconsin Privilege Dividend Tax Act, Sec. 3 of Chapter 505, Laws of 1935, amended by Chapter 552, Laws of 1935, and Chapters 233 and 309, Laws of 1937. The pertinent provisions of the Act are set forth in Appendix A hereto. That Act imposes "for the privilege of declaring and receiving dividends, out of income derived from property located and business transacted in" Wisconsin a tax equal to 2½% (now 3%) of the amount of such dividends declared and paid by all corporations (foreign and local), (with exceptions not here pertinent), after the passage and publication of the Act. The Act requires such tax to be deducted and withheld from such dividends payable to residents and non-residents by the payor corporation; and requires every such corporation made liable for the tax to deduct the amount of such tax from the dividends so declared.

The Act was to "take effect upon passage and publication" on September 26, 1935. It was applied by way of assessment in respect to all dividends declared and paid by Appellant subsequent to that date, notwithstanding a substantial part of the

accumulated Wisconsin income (so-called Wisconsin surplus) from which such dividends were declared and paid had been accumulated prior to the enactment of the law. (R. 34)

Since January 1, 1936, Appellant has been admitted to do business in every state of the Union, except Nevada. It had manufacturing plants and sales branches in many states. The proceeds of all sales and receipts from its operations and business went to Appellant's treasury department in Chicago, Illinois, and were there commingled without segregation or ear-marking, in the general funds of the corporation. (R. 20)

Every act and proceeding in respect to the declaration and payment of all dividends in question took place in Chicago, Illinois, where Appellant's Board of Directors met and declared them and where Appellant's treasury department drew and mailed dividend checks on Appellant's bank accounts representing its general funds on deposit in Chicago and New York. (R. 22) Such dividend checks were there mailed to Appellant's many stockholders, of whom during the period in question there were more than 32,000 in every state of the United States and many foreign countries. Less than 2% of Appellant's stockholders were residents of Wisconsin. (R. 36)

Appellant had outstanding both common stock and preferred stock on which it paid dividends quarterly. (R. 20) Appellant's dividends were not charged against the earnings or profits of any particular class or period, but were charged against surplus which resulted from and reflected the accumulated net profits and income from property wherever located and business wherever transacted. (R. 22) Appellant's charter state is New Jersey, and the applicable laws of that state permit directors of a corporation to pay dividends only from its surplus or from the net profits arising from the business of the corporation, which has been held to be the same as surplus. (R. 20) *National Newark*

etc. Co. v. Durant Motor Co., 1 Atl. (2d) 316; affirmed 125 N. Y. Eq. 435; 5 Atl. (2d) 767.

In prescribing the method for determining the amount of "dividends declared and paid out of income derived from property located and business transacted within the State of Wisconsin", by a corporation doing business within and without the state the Privilege Dividend Tax Act prescribed that "the amount of income attributable to this state shall be computed in accordance with the provisions of Chapter 71. In the absence of proof to the contrary, such dividends shall be presumed to have been paid out of earnings of such corporation attributable to Wisconsin under the provisions of Chapter 71, for the year immediately preceding the payment of such dividend." Chapter 71, which is the Wisconsin Income Tax Law, prescribes the method for determining taxable income of a corporation engaged in business within and without the state, and in that respect requires attribution of certain non-apportionable income, and the apportionment of the balance on the basis of the arithmetical average of three fractions representing, respectively, the ratios of tangible property, of cost of manufacturing, and of sales in Wisconsin to the total of each. (Sec. 71.02 (3) (d) Wis. Stats., set forth as Appendix B hereof.)

The Wisconsin Supreme Court, on remand of the *J. C. Penney case* from this Court, (*J. C. Penney Co. v. Wisconsin*, 238 Wis. 69; 298 N. W. 186), found that the Penney Company had paid its dividends out of surplus as of the end of the prior year rather than from income of that year, and thereupon declared that, "It must be presumed, however, that when it (the Company) drew upon the surplus which contained Wisconsin income, it drew upon Wisconsin income to the extent of the proportion which Wisconsin income bore not to the income for the year 1935, but to the whole amount of the surplus." Accordingly, in the instant case, and solely upon the authority of the above quoted language

of the Wisconsin Supreme Court, the Wisconsin Department of Taxation proceeded to compute the Wisconsin Privilege Dividend taxes against Appellant on a new formula not provided in the statute. (Exhibit 7a, R. 30–36)

The Department found for each year the percentage of Appellant's net income subject to Wisconsin *income tax*. This was found under the formula specified in Chapter 71, the Income Tax Chapter. It applied that percentage to the Appellant's *book income* for the same year. (Exhibit 7a, R. 30–36) Book income, of course, is a very different figure, from taxable income. For one thing, reserves are deducted in arriving at book income which cannot be deducted in arriving at taxable income.

By this method, the Department found the *book income* of Appellant derived from Wisconsin in each year. This *book income* derived from Wisconsin, was accumulated from year to year. The amount so accumulated was called Wisconsin earnings reflected in *surplus*. When a dividend was declared the Department estimated that so much of the dividend was derived from Wisconsin earnings as was found by applying to the dividend the ratio obtained by dividing so-called Wisconsin earnings reflected in surplus by total surplus. (Exhibit 7a, R. 33; R. 13, 14)

The result was taxed at 2½%. (Exhibit 7a, R. 33)

By stipulation, (Exhibit 7a R. 30–36), Appellant agreed that on the assumption that it paid its dividends from Wisconsin income in the proportion that its earnings from Wisconsin property and business reflected in its surplus bore to its total surplus, the computation of its Wisconsin privilege dividend taxes as set forth in said Exhibit 7a are correct. However, the Appellant reserved "the right to contest the validity of the privilege dividend tax law as applied to income or surplus accumulated prior to the enactment of said law, or as applied on the presumption that the International Harvester Company paid its dividends from Wisconsin income in the proportion that its earnings from Wis-

consin property and business, reflected in its surplus, bore to its total surplus, or as in any manner applied to the petitioner."

The only method specified by the statute would have required the Department to apply to the amount of the dividend the *income tax* fraction of the previous year obtained as the arithmetical average of the ratios of Wisconsin property to total property, Wisconsin sales to total sales, and Wisconsin cost of manufacturing to total cost of manufacturing.

The Wisconsin Department of Taxation included in total surplus on which the challenged tax was calculated, Appellant's surplus at the end of the year 1934, *preceding* the date (September 26, 1935) of the enactment of the Privilege Dividend Tax, amounting to $803,780.72. This figure had been increased by December 31, 1935, following the enactment of the law, to $2,227,499.03. (Exhibit 7a, R. 34) It follows that Appellant's surplus of $803,780.72, plus so much of the 1935 increase of $1,423,718.31 as had been accumulated before September 26, 1935, was surplus accumulated prior to the enactment of the Wisconsin Privilege Dividend Tax Law.

On the foregoing basis the Wisconsin Department of Taxation applied and assessed against Appellant the 2½% on its dividends declared and paid between December 2, 1935, and October 15, 1937. The tax amounted to $53,713.29 to which there was added penalties and interest to January 1, 1942, of $16,735.60, bringing the aggregate tax, interest and penalties to $70,088.89, all of which are involved on this appeal. (Exhibit 7a, R. 33, 48) The assessment was not made until after Appellant had made payment of the dividends to which it was applicable, and the tax was paid by Appellant under protest. No part of the tax was withheld from dividends. This suit was brought to obtain refund of the amount so paid.

On this factual basis the Wisconsin Supreme Court affirmed the assessments of privilege dividend taxes against Appellant.

Specification of Errors Relied Upon

(1) The Supreme Court of Wisconsin erred in failing to hold that Section 3 of Chapter 505, Laws of 1935, as amended by Chapter 552, Laws of 1935, and Chapters 233 and 309, Laws of 1937, as applied to International Harvester Company, a New Jersey corporation, and its stockholders, especially the non-residents of Wisconsin, under the undisputed facts of the case, was invalid because in effect an imposition of a tax on transactions beyond the State's jurisdiction and hence repugnant to the Fourteenth Amendment of the Constitution of the United States.

(2) The Supreme Court of Wisconsin erred in failing to hold that the assessments of taxes involved in this matter, purporting to have been made in pursuance of the provisions of Section 3 of Chapter 505, Laws of 1935, as amended by Chapter 552, Laws of 1935, and Chapters 233 and 309, Laws of 1937, against International Harvester Company, a New Jersey corporation, under the undisputed facts, operated to take the property of Appellant and of its stockholders, especially the non-residents of Wisconsin, without due process of law and in violation of the Fourteenth Amendment of the Constitution of the United States.

(3) The Supreme Court of Wisconsin erred in failing affirmatively to determine and hold that Section 3 of Chapter 505, Laws of 1935, as amended by Chapter 552, Laws of 1935, and Chapters 233 and 309, Laws of 1937, and the assessments of taxes thereunder against Appellant, insofar as the same operated or were applied to tax the distribution of income or profits of Appellant derived and accumulated prior to the enactment of that law, deprived Appellant and its stockholders of property without due process of law and in violation of the Fourteenth Amendment of the Constitution of the United States.

Summary of Argument

I.

The central contention of the Appellant is that the Wisconsin privilege dividend tax as applied to dividends paid by International Harvester Company, a New Jersey corporation with general offices in Chicago, Illinois, where the dividends were declared by directors at meetings held in Chicago, where the dividends were paid by checks mailed by the treasurer's office of the company in Chicago, drawn on its bank accounts in Chicago and New York, and where more than 98% of its stockholders resided outside of Wisconsin, is a denial of due process of law under the Fourteenth Amendment to the Constitution of the United States.

At the very outset we wish to emphasize that the situation presented in this appeal is different in several crucial respects from the situation presented in *Wisconsin v. J. C. Penney Co.*, 311 U. S. 435; 85 L. ed. 267. Because of these differences we submit that the *Penney case* in no way controls this case.

In the *Penney case, supra,* this Court held that the "descriptive pigeon-hole in which the state court puts a tax is of no moment in determining the constitutional significance of the exaction;" that for "constitutional purposes the decisive issue turns on the operating incidence of a challenged tax;" and declared that "the practical operation of this legislation is to impose an additional tax on corporate earnings within Wisconsin, but to postpone the liability for this tax until such earnings are paid out in dividends."

Since the *Penney case* was decided, the Wisconsin Supreme Court has made controlling determinations not merely as to the name or label given to the tax, but as to its actual operation.

When the *Penney case* came back to the Wisconsin Supreme Court on remand from this Court, the Wisconsin Supreme Court declared "that it has been consistently held that an income tax

is laid upon the recipient of an income", that the Wisconsin privilege dividend tax "in no sense and to no extent whatsoever is a tax upon income of the corporation", which does not receive the income. It declared that under the Wisconsin constitutional amendment authorizing the levying of income tax, an income tax could not be imposed upon income received by a non-resident stockholder.

In the case of *Blied v. Wisconsin Foundry and Machine Company*, 243 Wis. 221; 10 N. W. (2d), 142, the Wisconsin Supreme Court struck directly at the incidence of the tax. It held that the holder of preferred stock in a Wisconsin corporation could not require that his corporation pay him his dividend free of the Wisconsin privilege dividend tax but that the corporation must deduct the tax from the dividend.

In *Wisconsin Gas & Electric Co. v. Wisconsin Department of Taxation*, 243 Wis. 216; 10 N. W. (2d), 140, the Wisconsin Supreme Court held that the tax could not be absorbed as a business expense by the corporation and deducted on its Wisconsin income tax return.

Moreover, in the *Penney case* this Court noted as an argument in support of the view that the Wisconsin privilege dividend tax is an additional tax on corporate income that the proportion of the dividend attributable to Wisconsin was ascertained on the same formula under which net income is allocated to Wisconsin under the Wisconsin income tax. But as we have already shown (page 6) in the case at bar, the proportion of the dividend attributable to Wisconsin has not been ascertained on the "same formula" used in the income tax calculation, but on a new formula unknown to the Wisconsin income tax and the privilege dividend tax, by applying to the dividend the fraction obtained by dividing a figure called Wisconsin income reflected in surplus, or Wisconsin surplus, derived from Wisconsin in prior years, by the total surplus.

This particular argument in favor of the view that the Wisconsin privilege dividend tax is an additional tax on corporate income therefore does not apply to the case at bar.

It is evident, therefore, that the actual incidence and operation of this tax has now been definitely determined by the Wisconsin Supreme Court to be a tax on the stockholder and not on the corporation and that it cannot in its operation and incidence be any longer considered as an income tax either on the corporation or the stockholder.

It must, therefore, be considered as a privilege tax. The case at bar accordingly comes unmistakably under the rule of *Connecticut General Life Insurance Company v. Johnson*, 303 U. S. 77; 82 L. Ed. 673 and *Provident Life Assurance Society v. Kentucky*, 239 U. S. 103; 60 L. Ed. 167, where this Court held that taxes for the privilege of engaging in the life insurance business denied due process of law where the privileges taxed were not exercised in the taxing states.

II.

We submit that on the very ground adopted by the Wisconsin Supreme Court the tax, under accepted principles of due process, cannot be applied to dividends derived from surplus accumulated prior to September 26, 1935. In *Welch v. Henry*, 305 U. S. 134; 83 L. Ed. 87, this Court held that increased rates for an income tax could be applied retroactively only to "recent transactions." (P. 150)

In the case at bar, three of the Justices held that retroactivity "should only be permitted to 'recent' transactions" and that accordingly the privilege dividend tax "may not be applied to earnings in Wisconsin which accrued prior to the last corporate fiscal year preceding the enactment of the Wisconsin privilege dividend tax."

III.

Finally, Appellant contends that the amount of its dividends derived from Wisconsin, on which the taxes involved in this appeal have been computed, was ascertained on an unauthorized formula. The statute provides that the proportion of dividends derived from Wisconsin shall be found by the income tax formula. The proportion of Appellant's dividends derived from Wisconsin has been found by dividing an amount, called Wisconsin income reflected in surplus, by total surplus and applying the resulting fraction to the dividend. There is no authority in the statute for this method, and Appellant contends that the use of a method unauthorized by the statute is a denial of due process of law.

ARGUMENT

I.

The Wisconsin privilege dividend tax, as now authoritatively construed by the Wisconsin Supreme Court, is a privilege tax against the stockholder, and as applied to Appellant and its non-resident stockholders, takes property without due process contrary to the Fourteenth Amendment of the Federal Constitution.

The challenged judgment of the Wisconsin court affirms a tax imposed under the Wisconsin Privilege Dividend Tax Act. The validity of that Act is here drawn in question, and this Court has said that "for constitutional purposes the decisive issue turns on the operating incidence of a challenged tax." (*Wisconsin v. J. C. Penney Co.*, 311 U. S. 435, 444; 85 L. Ed. 267, 270)

We first look to the Act. The first sub-section provides:

> "For the privilege of declaring and receiving dividends, out of income derived from property located and business

transacted in this state, there is hereby imposed a tax equal to 2½% of the amount of such dividends declared and paid by all corporations (foreign and local) * * * after the passage and publication of this Act * * *. Such tax shall be deducted and withheld from such dividends payable to residents and non-residents by the payor corporation."

The provision that the tax shall be deducted and withheld from dividends is repeated in sub-sections (2) and (3) of the Act.

"Every corporation required to deduct and withhold any tax under this section shall, on or before the last day of the month following the payment of the dividend, make return thereof and pay the tax to the tax commission * * *.

(3) Every such corporation hereby made liable for such tax, shall deduct the amount of such tax from the dividends so declared."

(a) The decision of this Court in Wisconsin v. J. C. Penney Co., 311 U. S. 435, (1940) upholding the Wisconsin Privilege Dividend Tax Act, because based on a construction thereof since invalidated, is no longer controlling.

The constitutionality of the Wisconsin Privilege Dividend Tax Act was before this Court on *certiorari* to the Wisconsin Supreme Court in *Wisconsin v. J. C. Penney Co.*, 311 U. S. 435; 85 L. Ed. 267, and was sustained. That, however, was in 1940, and before the Wisconsin Supreme Court had placed a clear and unequivocal construction upon the law diametrically different from that proposed by this Court to sustain its constitutionality. The decision of this Court in the *J. C. Penney case* is, therefore, not controlling here.

In 1940 when the *J. C. Penney case* was brought to this Court on *certiorari* to the Wisconsin Supreme Court this Court thought that the Wisconsin court had gone no further than to "label", or classify, the Wisconsin Act. Indeed, this Court there expressly

recognized that "ascertainment of the scope of the exaction—what is included in it * * * is for the state court." "But" said this Court, "the descriptive pigeonhole into which the state court puts a tax is of no moment in determining the constitutional significance of the exaction." *Wisconsin v. J. C. Penney Co.*, 311 U. S. 435, 443; 85 L. Ed. 267.

It is true that at that time the Wisconsin court had determined nothing, had said nothing, as to the *operating incidence* of the tax. Actually all that the Wisconsin court had then done was to hold that the Act "imposed an excise or privilege tax upon the transaction involved of transferring the dividends from the corporation to its stockholders", and to declare:

> "It is agreed on all sides that the tax in question is an excise tax and this Court so held in the *Froedtert case.*" (*J. C. Penney Co. v. Tax Comm.*, 233 Wis. 286, 292; 289 N. W. 677).

When, therefore, there was presented to this Court on *certiorari* to the Wisconsin Supreme Court in *Wisconsin v. J. C. Penney Co., supra,* the question as to the validity of the Privilege Dividend Tax Act, challenged as violative of the due process clause of the Fourteenth Amendment, this Court doubtless approached the issue conscious of the duty to save the law if a constitutional interpretation could be found. Indeed, this Court said: "Nothing can be less helpful than for courts to go beyond the extremely limited restrictions that the Constitution places upon the states and to inject themselves in a merely negative way into the delicate way of fiscal policy-making." This Court recognized too that the tax in question, if it were to stand, must harmonize with the state's existing taxing system.

Admittedly the language of the Act was ambiguous and open to interpretation in respect to the incidence of the tax, for it imposed the tax "for the privilege of *declaring* and *receiving* divi-

dends." The transaction thus described has a double aspect. It involves not only two distinct acts, but the taxable acts are the acts of different parties, the corporation in *declaring*, the stockholder in *receiving*.

Thus circumstanced, this Court, in a five to four decision, declared:

> "The practical operation of this legislation is to impose an additional tax on corporate earnings within Wisconsin but to postpone the liability for this tax until such earnings are paid out in dividends. In a word, by its general income tax Wisconsin taxes corporate income that is taken in; by the privilege dividend tax of 1935 Wisconsin superimposed upon this income tax a tax on corporate income that is paid out."

The Court went on to reason (p. 442):

> "Had Wisconsin, as part of its price for the privileges afforded foreign corporations within its borders, explicitly provided for a supplementary tax on the Wisconsin earnings of such corporations, but postponed liability for the tax until such earnings were to be paid out in dividends, the power of Wisconsin to do so would hardly be questioned."

In ascertaining whether, by the tax in question, property was taken without due process of law, or, in other words, "whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state" the Court made this answer:

> "The substantial privilege of carrying on business in Wisconsin, which has here been given, clearly supports the tax." etc.

The view thus advanced in the majority opinion of this Court that the exaction might be sustained as an additional income tax *against the corporation* is epitomized in its statement of the inquiry "whether Wisconsin has transgressed its taxing power be-

cause its Supreme Court * * * has labeled it a tax on the privilege of *declaring* dividends rather than a supplementary income tax." It is significant that in this statement only the one aspect of the transaction described in the taxing statute is considered, namely, that of *declaring* the dividends, and that is the privilege exercised by the *corporation;* the privilege enjoyed by the *stockholder,* that of *receiving,* is not considered.

That the majority of this Court, in sustaining the Act, had viewed it as an additional tax on corporate earnings within Wisconsin was also the understanding of the minority. Mr. Justice Roberts, writing the minority opinion, said:

> "It is said that the challenged exaction is merely an additional income tax * * * in the view that in testing the constitutionality of an exaction this Court examines for itself the nature and incidence of the tax and disregards mere names and descriptive epithets."

This understanding as to the construction of the Act advanced by the majority in the *J. C. Penney case* was also consistently accepted in the lower federal courts. *Wisconsin Gas & Electric Co. v. U. S.*, 46 Fed. Supp. 929 (Dist. Ct. Eastern Dist. Wis. 1942); *Wisconsin Gas & Electric Co. v. U. S.*, 138 Fed. (2d), 597 (Cir. Ct. of App. 8th Cir., Nov. 8, 1943); *Montreal Mining Co. v. Comm.*, 2 Tax Court of U. S. No. 85, (Docket No. 106876), decided Sept. 16, 1943.[1]

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[1] In *Wisconsin Gas & Electric Co. v. U. S.*, 46 Fed. Supp. 929 (1942) the Federal District Court for the Eastern District of Wisconsin had before it the question whether for federal income tax purposes the corporation was entitled to take a deduction of the Wisconsin privilege dividend tax. (That case is now before this Court on certiorari to the Circuit Court of Appeals for the Seventh District, being No. 565 on the present calendar. It was argued here on March 10, 1944.)

The District Court compared the majority and the minority opinions in *Wisconsin v. J. C. Penney Co.*, 311 U. S. 435 and concluded:

> "We would be strongly inclined to agree with the opinion expressed by the minority, but are bound to follow the conclusion of the majority opinion, which states at page 442 of 311 U. S. at page 248 of 61 S. Ct.: '* * * The practical operation of this legislation is to impose an additional tax on corporate earnings within Wisconsin but to postpone the liability for this tax until such earnings are paid out in dividends. In a word, by its general

It, therefore, clearly appears that this Court, while declaring that "ascertainment of the scope of the exaction—what is in-

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income tax Wisconsin taxes corporate income that is taken in; by the Privilege Dividend Tax of 1935 Wisconsin superimposed upon this income tax a tax on corporate income that is paid out.'

"These words of the majority opinion cannot be lightly brushed aside. On this point there was a direct and emphatic conflict with the viewpoint of the minority. If the Wisconsin privilege divdend tax 'is to impose an additional tax on corporate earnings', and if 'by the Privilege Dividend Tax of 1935 Wisconsin superimposed upon this income tax a tax on corporate income that is paid out', then there can be little doubt but that the majority of the Supreme Court held the tax to be on the corporation and not upon the shareholders. It is apparent that the validity of the tax was upheld on that basis." P. 930.

The above quoted decision of the District Court was appealed by the government to the Circuit Court of Appeals, (7th Cir.), but pending such appeal the Wisconsin Supreme Court rendered its decision in the instant case, *International Harvester Co. v. Wisconsin Department of Taxation*, 243 Wis. 198, and in the compa.ion cases of *Wisconsin Gas & Electric Co. v. Wisconsin Department of Taxation*, 243 Wis. 216, and *Blied v. Wisconsin Foundry & Machine Co.*, 243 Wis. 221. In view of those decisions of the Wisconsin court, the Circuit Court of Appeals reversed the District Court and held that the corporation was not entitled, in determining its federal income tax, to deduct the Wisconsin privilege dividend tax. See *Wisconsin Gas & Electric Co. v. U. S.*, 138 Fed. (2d) 597, decided November 8, 1943.

However, the Circuit Court of Appeals recognized that at the time the District Court decided the case the Wisconsin Supreme Court had not decided the cases just cited, but had relied on the decision of this Court in the *J. C. Penney case*, and of this the Circuit Court of Appeals said: "The reasoning of that case would seem to sustain the District Court's position."

In *Montreal Mining Co. v. Commissioner*, 2 Tax Court, U. S. No. 85, decided September 16, 1943, there was involved the question of deductibility of the Wisconsin privilege dividend tax for purposes of federal income tax, the same question as is presented in the *Wisconsin Gas & Electric Co. case, supra*. The tax court's decision was rendered subsequent to the Wisconsin cases above noted, but prior to the decision of the Circuit Court of Appeals in the *Wisconsin Gas & Electric Co. case*. The commissioner there contended that the privilege dividend tax is a levy upon the stockholders and consequently should be disregarded entirely in the taxation of a corporation's income. The Tax Court quoted from this Court's decision in the *J. C. Penney case* to the effect that practical operation of the legislation was to impose an additional tax on corporate earnings within Wisconsin and concluded:

> "Thus, it is apparent that the tax in question was there determined to be a levy on corporate income. Upon the authority of that decision, we hold in petitioner's favor on this issue. The tax is deductible under section 23 (c) of the Revenue Acts of 1934 and 1936."

See also opinion in the instant case rendered by Judge Alvin C. Reis, Circuit Judge. That opinion is set forth at Record pages 48–56. Judge Reis said (R. 50): "When, however, this case [*J. C. Penney case*] reached the Supreme Court of the United States, that tribunal regarded this tax as a 'supplementary income tax' upon the corporation and hence clearly within the power of the state to impose and not fringing upon the Fourteenth Amendment."

cluded in it * * * is for the state court", but finding that the state court had not *construed* the law to the extent necessary to enable this Court to apply the tests for determining whether it operated to take property without due process under the Fourteenth Amendment, itself held out a possible construction of the law which would bring it within the principles of due process under the Fourteenth Amendment.

This did not preclude the Wisconsin court from declining to accept the construction thus proffered by this Court, it did not preclude the state court from placing upon the Act its own authoritative construction fixing the actual incidence and burden of the tax. Indeed, this Court has conclusively held that while it determines whether a state statute violates the federal constitution by considering its actual operation and incidence irrespective of the name or label which either the state legislature or the state court may have given the statute, nevertheless the state supreme court determines finally the actual operation of the statute.

The state supreme court determines who pays a tax, how the tax is collected, and on whom the tax is a burden.

In *J. Bacon & Sons v. Martin*, 305 U. S., 380; 83 L. Ed., 233, the Appellant contended that a Kentucky statute imposing a tax on the "receipt" of cosmetics in the state by any Kentucky retailer was a burden on interstate commerce as applied to articles purchased by him from manufacturers and dealers in other states and transported to the Appellant's place of business in Kentucky. The Court of Appeals of Kentucky had construed the statute to define "receipt" as meaning not only the act of receiving cosmetics, but the sale and use of cosmetics after the retailer had received them, and that the excise tax was imposed on such sale and use after receipt.

This Court said "the construction of the statute by the state Supreme Court is binding upon us."

In *Federal Land Bank of St. Paul v. Bismark Lumber Co.*, 314 U. S., 95; 86 L. Ed., 65, the question involved was whether a federal land bank was subject to the state sales tax on purchases of materials for use in repairing and improving buildings and fences on farm lands acquired by the bank through foreclosure of farm mortgages, the bank claiming exemption as a federal instrumentality.

This Court said that it was clear that the North Dakota statute made the purchaser of land, there the federal land bank, liable for the sales tax. It said that the Act required the retailer to add the sales tax to the sale price and declared the tax to be a debt from the consumer to the retailer. This Court noted that the North Dakota Act made it unlawful for the retailer to hold out that he would absorb or refund the tax in whole or in part. It added that the Supreme Court of North Dakota has held that the sales tax is laid on the purchaser, and said: "these determinations of the incidence of the tax by the state court are controlling and respondents concede the point."

This Court will, of course, apply the state law as construed by the state courts as of the time when the appeal is disposed of rather than as of some earlier date, as though in the meantime the state legislature had amended the law. It will, moreover, abandon its former decision construing a state statute if the state courts have subsequently given to it a different construction.

Vanderbark v. Owens Illinois Glass Co., 311 U. S. 538; 85 L. Ed., 327, 330.

Green v. Lessee of Neal, 6 Peters, 291; 8 L. Ed., 402.

Fairfield v. Gallotin County, 10 Otto, 47; 25 L. Ed., 544, 546.

While, therefore, this Court is the final authority for determining whether the tax in its actual operation violates the due

process clause of the Fourteenth Amendment, we submit that this Court clearly accepts the operating incidence of the tax as determined by the state supreme court in its consideration of the constitutional question.

What then the state supreme court calls the tax, whether income, privilege or property tax, is not conclusive on this Court. But who pays the tax, who collects the tax, on whom the tax is a burden,—these questions clearly are finally determined by the state supreme court.

Since the decision of this Court in the *Penney Case*, there have been vital determinations made by the Wisconsin Supreme Court as to the actual incidence of this tax which we submit, together with other factors which we will present below, make the situation presented here materially different from that presented to this Court in the *Penney Case* and prevents the *Penney Case* from in any way determining the issues in this case.

(b) The Wisconsin Supreme Court, exercising its acknowledged function to construe the state law, denied that it was an income tax on corporate earnings, and declared it to be a privilege tax against the stockholder.

Subsequent to this Court's decision in the *J. C. Penney case, supra*, the Wisconsin Supreme Court, at its first opportunity, insisted upon its acknowledged right to construe the Privilege Dividend Tax Act and to set at rest the incidence of the tax. In so doing the Wisconsin court unequivocally refused to accept the construction proffered by this Court, and placed its own construction upon the Act consistent with the Wisconsin Constitution and existing tax structure.

Upon remand in the *J. C. Penney Case* the Wisconsin court noted the language of this Court that "the practical operation of this legislation is to impose an additional tax on corporate

earnings within Wisconsin, but to postpone the liability for this tax until such earnings are paid out in dividends", but declared in explanation of its previous characterization of the law (p. 72):

> "Inasmuch as the legislature expressly declared the tax to be for the 'privilege of declaring and receiving dividends', we denominated it an excise or privilege tax. *State ex rel. Froedtert G. & M. Co. v. Tax Comm.* (1936), 221 Wis., 225, 233; 265 N. W. 672, 267 N. W. 52."

The Wisconsin court then prefaced its further exposition of the law by this statement of principles:

> "As we understand the law our construction of the state statute is conclusive upon the Supreme Court of the United States. *Erie R. Co. v. Tompkins* (1938), 304 U. S. 64; * * *; *Swift v. Tyson* (1842), 16 Pet. 1 * * * See Note 83 L. Ed., 518."

Then by way of definition and construction of the Act the Wisconsin court proceeded:

> "It is perfectly true that the tax cannot be sustained as an income tax under the law of this state. Under our constitutional amendment authorizing the levying of an income tax, sec. 1, art. VIII, Const., it has been consistently held that an income tax is a burden laid upon the recipient of an income and the amount of the tax is measured by the amount of the income. *State ex rel. Sallie F. Moon Co. v. Wis. Tax Comm.* (1917) 166 Wis. 287, 163 N. W. 639, 165 N. W. 470. Under its laws this state cannot and it does not undertake to tax the income of citizens of other states who are not doing business in this state. Under the terms of the statute under consideration no tax is levied until a dividend is declared. When the dividend is declared the dividend belongs to the stockholder. It is a debt of the corporation for the recovery of which the stockholder may maintain an action. Inasmuch as the tax cannot be levied until the dividend is declared if it is not *a tax on the pri-*

> *ilege of declaring and receiving a dividend as we hold it to be,* then it must be a tax on the recipient, a person not engaged in doing business in this state nor a resident thereof. In no sense and to no extent whatever, is it a tax upon the income of the corporation." (Emphasis supplied)

Notwithstanding the Wisconsin Court's construction of the Act, and its refusal to accept the construction proffered by this Court, the state court upon remand in the *J. C. Penney case* considered that it was bound by this Court's determination as to Wisconsin's jurisdiction to levy the tax in question, and it yielded upon that ground only, steadfastly insisting "that to construe the statute * * * is a matter under the decisions of the Supreme Court of the United States which is clearly a function of this (Wisconsin Supreme) Court * * *."

In *Wisconsin v. J. C. Penney Co., supra;* this Court, reiterating the principle of numerous earlier decisions, stated the "guiding formulation for adjudicating a tax measure":

> "* * * in passing on its constitutionality we are concerned only with its practical operation, not its definition or the precise form of descriptive words which may be applied to it."

And again, more concretely:

> "For constitutional purposes the decisive issue turns on the operating incidence of the tax."

So it was that following the *J. C. Penney case* the Wisconsin Supreme Court had occasion in several cases to determine "the practical operation" the "operating incidence" of the Privilege Dividend Tax.

Besides the instant case there were *Blied v. Wisconsin Foundry and Machine Company,* 243 Wis., 221; 10 N. W. (2d) 142, and *Wisconsin Gas & Electric Co. v. Wisconsin Department of Taxation,* 243 Wis., 216; 10 N. W. (2d) 140. The

decisions in all of these cases were rendered on the same day, June 16, 1943. The decision in the instant case, as well as in the other two cases referred to, and rendered at the same time, have been set forth in the "Statement as to Jurisdiction" in this case.

Blied v. Wisconsin Foundry & Machine Company, supra, involved a suit by a preferred stockholder against his corporation to recover an amount withheld by the corporation from the preferred stock dividends and paid to Wisconsin on account of its privilege dividend tax. Plaintiff contended that under the decisions the tax was not against the stockholder, but against the corporation, since the corporation alone was made liable for the tax, was liable for the penalty and interest on failure to pay the tax, and since no personal liability was imposed upon the stockholder. The court stated the plaintiff's case thus:

> "It is contended that the United States supreme court in *Wisconsin v. J. C. Penney Co.,* 311 U. S. 435, 61 Sup. Ct. 246, 85 L. Ed. 267, construed the tax as one upon corporate earnings, and held that the basis of the tax is the privilege to the corporation of doing business in this state. It is further contended that if construed to be one upon the stockholders, the tax is unconstitutional and void because no privileges were conferred by Wisconsin upon the stockholders who are not residents of the state and have neither done business in the state nor declared the dividends which are taxed."

These contentions, the court said were identical with those dealt with in *Wisconsin Gas & Electric Co. v. Department of Taxation, supra,* and reference was made to the decision in that case as controlling. Judgment was affirmed dismissing the complaint for the reason that

> "the specific requirements of the statute which we hold to be valid are that the tax be withheld and deducted from the dividends payable to the stockholder."

In *Wisconsin Gas & Electric Co. v. Department of Taxation, supra,* which was held to control *Blied v. Wisconsin Foundry and Machine Company, supra,* the question was whether the Wisconsin privilege dividend tax paid by the corporation was a proper deduction from gross income in ascertaining the Wisconsin income tax. The taxpayer there, as in the *Blied Case, supra,* contended that the tax upon the privilege of declaring dividends was upon the corporation and constituted a duly and necessary expense of doing business. For this contention the taxpayer relied upon the decision of this Court in *Wisconsin v. J. C. Penney Co.,* 311 U. S. 435; 85 L. Ed. 267, to the effect that the tax was "the return asked for the substantial privilege of carrying on corporate business in Wisconsin, although conditioned upon happenings outside the borders of the state." Upon the question whether the privilege dividend tax was upon the corporation the Wisconsin court said (p. 219):

> "The real question in this case is: On whom is the actual burden of this tax laid? This question can have but one answer. The statute specifically puts it upon the stockholder. The corporation is directed to deduct the tax from the dividends and if it does as it is required to do, it sustains no expense and consequently may not, in any event, deduct the tax from its gross income. It is contended that the foreign stockholder of a foreign corporation has done no business in Wisconsin for which the tax may validly be levied. This contention was foreclosed when the supreme court of the United States sustained the power of Wisconsin to levy this tax. It made its determination with the statute before it—a statute that plainly puts the burden of this tax upon the stockholder and not upon the corporation. So far as Wisconsin's power to reach beyond its borders and to levy the tax is concerned, the United States Supreme Court has declared that Wisconsin has the right to exact the tax because of protection given to corporate activities in this state resulting in earnings traceable to the

> dividends declared and benefits to the stockholder who has received a dividend. At this stage of the litigation we are not concerned with the question of the power to tax and we must assume that the power vindicated is the power to levy the very tax that was before the United States supreme court for consideration. That power having been sustained, regardless of what the tax be called or where its burdens may be considered to fall, it is immaterial that the United State supreme court has not merely regarded the privilege features of the tax as unimportant but has to some extent disregarded the corporate entity in view of the real benefits conferred by the state upon the stockholder. We are certain of three things: (1) That the burden of the tax is specifically laid upon the stockholder; (2) that the corporation declaring the dividend must deduct the tax from the dividend and may not under any circumstances treat the tax as a necessary expense of doing business; (3) that the power to levy the tax so construed was authoritatively established in the *Penney Case, supra.* It follows that appellants' contentions must fail."

The Wisconsin Supreme Court in its decision in the instant case did not find it necessary further to dwell upon the point, unequivocally decided by it in the *Blied case,* and in the *Wisconsin Gas & Electric case, supra,* that the tax was against the stockholder and deductible from the dividends due him. That court did, however, in various forms reiterate its previous determination that the tax is "a privilege tax and not an income tax." Entirely disregarding its unequivocal determination that the exaction is in no sense an income tax and not a tax against the corporation, and that the incidence of the tax is upon the stockholder, indeed, without any regard to the incidence of the challenged exaction, the Wisconsin Supreme Court in the instant case interprets the decision of this Court in the *J. C. Penney case* to hold as the *"jurisdictional fact"* justifying the tax that the corporation paid dividends in whole or in part

out of property located in this state or business transacted here, and that

> "the basis of Wisconsin's power to tax is the fact that it has given its protection and the benefits of government to corporate activities in Wisconsin and that profits from these activities are traceable to the fund from which dividends are paid. So far as the constitutional aspects of the cases are concerned, the Federal Supreme Court (of the United States) has reduced the privilege feature of the tax to mere conditions and contingencies upon the happening of which the tax accrues."

This bare statement of the supposititious basis of Wisconsin's power to tax is the ultimate concept of that power *forced* upon the Wisconsin court by its supposed necessity of accepting this Court's mandate that Wisconsin had power to pass the precise tax Act before it, but without any corresponding necessity on the part of the state court of accepting this Court's construction of the Act. The statement, therefore, discards those supports which this Court offered by way of construction of the Act, but which the state court, in the exercise of its acknowledged function to construe the state statute, refused to accept. This statement of the supposed basis of power to tax therefore ignores, because the Wisconsin court refused to accept it, the very foundation which this Court had attempted to lay under the dividend tax, namely, that it was an additional tax on corporate earnings, a supplementary income tax against the corporation. We submit that the Wisconsin Supreme Court, by such an interpretation of the decisions of this Court has assumed, however unwillingly, to commit this Court to a doctrine of state taxing power so broad in scope, so dangerous in concept, and so at war with all precedents, as to be utterly untenable.

It thus becomes clear from the decisions of the Wisconsin Supreme Court upon remand in *J. C. Penney Co. v. Tax Comm.*,

238 Wis., 69, 298 N. W. 186 and in the more recent cases of *Blied v. Wisconsin Foundry & Machine Co.*, 243 Wis., 221; 10 N. W. (2d) 142, *Wisconsin Gas & Electric Co. v. Department of Taxation*, 243 Wis., 216; 10 N. W. (2d) 140 and in the instant case, that the Wisconsin Supreme Court has flatly and stoutly refused to accept this Court's proffered construction of the Wisconsin Privilege Dividend Tax Act as an additional or supplemental income tax against the corporation on account of its earnings in Wisconsin. The Wisconsin court has steadfastly insisted upon its acknowledged right to construe the statutes of the state. It has now, as it had not at the time (Dec. 16, 1940) when this Court decided *Wisconsin v. J. C. Penney Co., supra*, unequivocally determined that the tax is not an income tax and as such could not be sustained under the Wisconsin law; that if it were an income tax at all then under the provision of the Wisconsin Constitution for the levy of income taxes it would be against the stockholder, and Wisconsin cannot tax the income of citizens of other states who are not doing business in Wisconsin; specifically "that in no sense and to no extent whatever is it a tax upon the income of the corporation;" and that the exaction "is as the legislature declared it to be, a privilege or excise tax upon the transaction of declaring and receiving dividends", and is, moreover, imposed upon the stockholder and required to be withheld and deducted from his dividends.

(c) The Wisconsin court has now so fully and unequivocally construed the Act as to yield to tests of constitutionality declared by this Court; so tested the Act is condemned as an attempt to tax privileges enjoyed elsewhere and neither granted nor controlled by Wisconsin.

The Wisconsin court, therefore, has now decided everything needed to demonstrate the *practical operation* of the legislation; it has unequivocally determined the "operating incidence" of

the challenged tax. Accordingly, the Wisconsin court now, by its decisions, has construed the act of its legislature, with the same effect as though written in by the legislature itself, so as to embody in that legislation definite answers to all of these tests laid down by this Court for determining the constitutional validity of the challenged tax. (See *Wisconsin v. J. C. Penney Co.*, 311 U. S. 435, 443; 85 L. Ed. 267). The construction so written into the law by the Wisconsin court is diametrically opposed to that interpretation placed on the Act by this Court in the *J. C. Penney Company case* for the purpose of sustaining the law.

Summarizing, the Wisconsin Supreme Court since the *Penney case* has made the following determinations as to who pays the tax and on whom it is a burden, in other words, the "operating incidence" and the "practical operation":

The tax is not on income received and therefore cannot be an additional corporate income tax, since an income tax in Wisconsin is laid only on income received.

The corporation paying the dividend is required to withhold the tax from the dividend and may not absorb it as a business expense.

The corporation cannot deduct the tax as a business expense on its Wisconsin income tax return.

The tax is imposed on the stockholder and under the Wisconsin Constitution it would not be constitutional as a tax on income of nonresident stockholders.

All these determinations we submit are final and binding on this Court under the decisions above cited.

Moreover, the tax is not calculated under the income tax formula.

Finally, and as a further indication of the changed situation since the *Penney case* was decided by this Court, we submit as a

further argument against the designation of this tax as a tax on income that the tax assessed against Appellant, and involved on this appeal, was not assessed on the income tax formula as had been done in the *Penney case.*

This Court noted in its opinion in the *Penney case* (p. 441) that:

> "In the enforcement of this measure against foreign corporations, the amount of income attributable to Wisconsin is calculated according to the same formula as that employed in assessing the general corporate income tax paid by such foreign corporations."

We shall consider the formula adopted in assessing the tax on this appeal more particularly below but at this point we wish merely to note that the formula on which the tax against the International Harvester Company was assessed is not the same formula as that used in the Wisconsin Income Tax.

The Wisconsin Income Tax is assessed by applying to the apportionable net income of a corporation doing business within and without Wisconsin the average of three ratios: (1) the ratio of Wisconsin tangible property to total tangible property; (2) the ratio of Wisconsin cost of manufacturing to total cost of manufacturing; (3) the ratio of Wisconsin sales to total sales. The average of these three ratios is applied to total apportionable net income subject to income tax.

This is the income tax formula and this was the formula applied to the *Penney case*. This formula has not been used in the case at bar.

The proportion of the Appellant's dividends attributable to Wisconsin has been found by dividing so-called Wisconsin income reflected in *surplus* by total *surplus* and applying the resulting fraction to the total dividend.

It is obvious that the proportion of the dividend taxed is not found on the income tax formula and therefore, the assumption

that the tax is an additional corporate income tax because the income tax formula is used, does not apply to the taxes on this appeal.

We submit therefore that this Court now takes the tax for its consideration in the light of these controlling determinations made by the Wisconsin Supreme Court, since the *Penney case* was decided, and that it is now for this Court to determine in the light of these decisions of the Wisconsin Supreme Court as to the actual operation and burden of the tax, whether the tax denies due process of law under the Fourteenth Amendment.

A tax which is not paid by the corporation, which is not based on income of the corporation, which cannot be deducted, as an expense from income received by the corporation, and which must be withheld from dividends paid to the stockholders, bears no resemblance to a corporate income tax. And as an income tax on the non-resident stockholders it would be unconstitutional. Therefore, in the light of the above determinations we submit that this Wisconsin privilege dividend tax can no longer be treated as an income tax, either on the corporation or on the non-resident stockholder.

With the foundation for this Court's decision in *Wisconsin v. J. C. Penney Co.*, 311 U. S. 435; 85 L. Ed. 267, swept away, and that case no longer controlling in respect to the validity of the Wisconsin privilege dividend tax, the principles announced by this Court in *Connecticut General Life Insurance Co. v. Johnson*, 303 U. S., 77; 82 L. Ed., 673, are now controlling and require this Court to strike down the Wisconsin Act as applied to foreign corporations and their non-resident stockholders. In that case Connecticut General Life Insurance Company did business in California under license from that state, and in addition to such local business entered into contracts with other insurance companies also licensed in California reinsuring them against loss

on policies written by them in California on the lives of California residents. The reinsurance contracts were made in Connecticut, premiums were paid there and the losses, if any, were there payable. California imposed a tax upon the privilege of the company to do business within California, measuring that tax by gross premiums received. California officials attempted to collect the tax on premiums received by the Connecticut corporation under the reinsurance contracts in question, and the California Supreme Court sustained the tax. On appeal this Court held that the law was unconstitutional because it attempted to tax the privilege of doing acts which were not done in California. In answer to the argument that because the reinsurance transactions were so related to business carried on by the Insurance Company in California as to be a part of it and properly included in the measure of the tax, this Court said (p. 80):

> "But the limits of the state's legislative jurisdiction to tax, prescribed by the Fourteenth Amendment, are to be ascertained by reference to the incidence of the tax upon its objects rather than the ultimate thrust of the economic benefits and burdens of transactions within the state. As a matter of convenience and certainty, and to secure a practically just operation of the constitutional prohibition, we look to the state power to control the objects of the tax as marking the boundaries of the power to lay it. Hence it is that a state which controls the property and activities within its boundaries of a foreign corporation admitted to do business there may tax them. But the due process clause denies to the state power to tax or regulate the corporation's property and activities elsewhere." (Citing ten U. S. Supreme Court decisions)

This Court then used the following pertinent language, equally appropriate to the instant case:

> "It follows that such a tax, otherwise unconstitutional, is not converted into a valid exaction merely because the cor-

poration enjoys outside the state economic benefits from transactions within it, which the state might but does not tax, or because the state might tax the transactions which the corporation carries on outside the state if it were induced to carry them on within."

The Court pointed out that apart from the fact that the Insurance Company in that case was privileged to do business in California, and that the risks reinsured were originally insured against in California by companies also authorized to do business there, California had no relationship to the Insurance Company or to the reinsurance contracts. Again this Court used language equally appropriate to the case at bar:

> "No act in the course of their (contracts') formation, performance or discharge, took place there. The performance of those acts was not dependent upon any privilege or authority granted by it, and California laws afforded to them no protection.
>
> The grant by the state of the privilege of doing business there and its consequent authority to tax the privilege do not withdraw from the protection of the due process clause the privilege, which California does not grant, of doing business elsewhere."

In *Wisconsin v. J. C. Penney Co., supra,* the dissenting opinion, considering the Wisconsin privilege dividend tax was an excise tax upon a privilege exercised outside of Wisconsin and laid upon the stockholder, said:

> "Upon the facts, a tax is levied on what lies outside the sovereignty of Wisconsin. Its attempted collection is a violation of the Due Process Clause of the Fourteenth Amendment and should be stricken down.
>
> The Supreme Court of Wisconsin could not have decided otherwise in the light of a recent expression of this court on the subject. In reaching its decision it professedly followed and applied *Connecticut General Life Insurance Co. v. Johnson,* 303 U. S. 77."

There can no longer be any dispute that the tax in question is exactly what the minority in the *J. C. Penney case* took it to be. The Wisconsin Supreme Court has in the meantime unequivocally construed it that way. The observations contained in the dissenting opinion, above quoted, are therefore completely applicable.

As suggested by the language of the dissenting opinion in the *J. C. Penney case, supra,* the Wisconsin court, when the *Penney* case was first before it:

> "* * * held that in its application to a foreign corporation doing business in Wisconsin and deriving a portion of its surplus from net earnings in Wisconsin, the law was an unconstitutional attempt by Wisconsin to tax a privilege which it neither gave nor protected, and that Wisconsin was consequently without jurisdiction to levy the tax."

As later explained by the Wisconsin court in its decision in the instant case, for the principle just quoted,

> "This court (Wisconsin Supreme Court) relied principally on the case of *Connecticut General Life Ins. Co. v. Johnson,* 303 U. S. 77, where upon facts that appeared to us to be quite indistinguishable the Supreme Court of the United States had held California to be without jurisdiction to levy a privilege tax", etc.

Equally applicable to the case at bar, and likewise fatal to the Wisconsin Privilege Dividend Tax, are the principles stated by this Court in *Provident Savings Life Assurance Society v. Kentucky,* 239 U. S. 103; 60 L. Ed. 167.

That case, involving a privilege tax on a life insurance company which previously had carried on a life insurance business in Kentucky, still continued its contracts on lives of Kentucky residents, but had withdrawn from Kentucky and thereafter collected premiums on its Kentucky contracts at its home office in New York. This Court held that Kentucky could not lay a privilege tax against the Company, saying:

"Taxation without jurisdiction has been held to be a violation of the Fourteenth Amendment (*Louisville & J. F. Co. v. Kentucky*, 188 U. S. 385; *Delaware & W. R. Co. v. Penn.*, 198 U. S. 341; *Union Ref. Transit Co. v. Kentucky*, 199 U. S. 194); and the principle involved applies to the assertion of authority on the part of the state to exact a license tax for the privilege of doing acts which lie beyond the sphere of local control." (P. 112)

The Court continued:

"There is, however, a manifest difficulty in holding that the mere continuance of the obligation of the policies constituted the transaction of a local business for which a privilege tax could be exacted. As a privilege tax, the tax rests upon the assumption that what is done depends upon the state's consent. But the continuance of the contracts of insurance already written by the company was not dependent on the consent of the state. * * * These policies are contracts already made; the state cannot destroy them or make their mere continuance, independent of acts within its limits, a privilege to be granted or withheld. Neither the continuance of the obligation in itself, nor acts done elsewhere on account of it, can be regarded as being within the state's control." (Pages 113–114)

Between this Kentucky case and the case at bar there is a striking parallel. We have quoted the observations of this Court that the continuance of contracts of insurance previously written by the Insurance Company was not dependent upon the consent of the state, and for that reason Kentucky was held without power to impose the privilege tax there involved. After the income derived by Appellant from Wisconsin business had been realized, and was forwarded to its home office in Illinois discharged of whatever tax had been imposed by Wisconsin upon its receipt, such funds became a portion of the general mass of Appellant's property, held and administered at its general office in Chicago.

The disposition of those funds by appropriate corporate action taken outside of Wisconsin was as independent of the consent of Wisconsin as was the continuance of life insurance contracts on the Kentucky lives. Indeed, the gap between the earning of the income in Wisconsin and the receipt of dividends by Appellant's non-resident stockholders is even greater, since the privilege of earning is granted by Wisconsin to the corporation, whereas the privilege of receiving the dividend, which essentially is the privilege here sought to be taxed, is enjoyed by one who may never have transacted business in the state.

Especially appropriate to the corporate funds derived by Appellant from its Wisconsin property and business after such funds had become a part of the general mass of the corporation's property held outside of Wisconsin, are these observations found in the dissenting opinion in the *J. C. Penney case* (p. 448):

> "The funds may be employed in the extension of its business; they may be held as insurance against future business losses or they may be distributed to its stockholders in dividends. Their management and their disbursement have no relation to the original receipt of income save only the fact that, like most property, they are built up as the fruits of income. Their use and their disbursement does not depend on any law of Wisconsin and cannot be controlled by any such law. The act of disbursing them, whether in payment of corporate obligations or as dividends, is one wholly beyond the reach of Wisconsin's sovereign power, one which it cannot effectively command, or prohibit or condition. That distribution cannot be the subject of an excise tax by the State of Wisconsin."

We think it was well said in the dissenting opinion in the *Penney case*, 311 U. S. 435, 447; 85 L. Ed. 267, "one cannot intelligently discuss things or acts except by using the names commonly employed to describe them. Concepts of ad valorem taxa-

tion on property and taxation of income, are clearly and easily discriminable."

In short, there must be some order and system in taxation and it is practically impossible to consider the constitutionality of a taxing statute, either state or federal, without examining the nature of the tax involved, not according to its mere name or label, but according to its actual operation or incidence.

From the very beginning this Court has found it necessary in considering the constitutionality of federal and state taxing statutes to classify taxes. As early as *Hylton v. U. S.*, 3 Dallas, 171; 1 L. Ed. 556, this Court held that a tax on carriages was not a direct tax on carriages as property, which, under the Constitution, would have to be apportioned according to population, but was an excise tax. This Court many times has had before it a tax which might be considered either a privilege tax or a property tax, and the determination of the character of the tax by its actual operation and incidence has been vital to the determination of the constitutionality of the tax.

For example, in *East Ohio Gas Co. v. Tax Commission*, 283 U. S. 465; 75 L. Ed. 1171, this Court said (p. 470): "Admittedly the exaction is not a tax on property or in lieu of a property tax." It said that the statute "calls it, and in fact, it is, a tax for the privilege of carrying on intrastate business." The Court held that the tax was applied to gross receipts wholly from intrastate business and therefore upheld the tax.

We refer also to *Pullman Co. v. Richardson*, 261 U. S. 330, 67 L. Ed. 682; *Hopkins v. So. Cal. Tel. Co.*, 275 U. S. 393, 72 L. Ed. 329; and *Galveston, Harrisburg & San Antonio Ry. Co. v. Texas*, 210 U. S. 217; 52 L. Ed. 1031. In each of these cases the court found it necessary to consider whether the tax was a property tax, or a privilege tax on gross receipts, for the purpose of determining its constitutionality.

But in whatever class the Wisconsin Privilege Dividend Tax is placed, we submit that it cannot be sustained on this appeal.

We have already conclusively shown that it can no longer be treated as an income tax.

We have also just shown that it cannot be constitutional as a privilege tax on the privilege of declaring and receiving dividends.

Clearly it would not be constitutional as a tax on the fund from which the dividends are paid since that fund was located entirely outside of Wisconsin. That fund was derived from earnings of prior years, and it was an intermingled fund in which the earnings of prior years had lost their identity. The dividends were not only paid out of that surplus, but the dividends paid in 1937 were *necessarily* paid out of surplus since there was not sufficient book income in the fiscal year ending October 31, 1936, to provide for the dividends paid in 1937. In 1937 total dividends amounting to $21,268,811.92 were paid. The book income of Appellant in 1936 was only $18,948,047.35. (Ex. 7a, R. 33, 34)

We submit that no one would contend that if funds of a taxpayer partly derived from Wisconsin earnings are used to purchase a building in Chicago or New York, that Wisconsin could impose a property tax on a portion of the value of the building, nor would anyone contend that a portion of the rents received by the taxpayer from outside tenants of that building could be taxed by Wisconsin.

To summarize:

With the abandonment of the hypothesis that the Privilege Dividend Tax might be treated as a supplemental income tax on corporate earnings in Wisconsin, with that support to the Wisconsin power to impose the tax swept away, the exaction is disclosed to be, what appears from the very face of the law, an attempt to impose a privilege tax against stockholders, whether resident or non-resident, on the declaration and receipt of divi-

dends. This, as to Appellant, a foreign corporation, and its stockholders, of whom more than 98% reside outside of Wisconsin, must be condemned as an attempt by Wisconsin to exact a tax for a privilege which Wisconsin does not grant and which it can neither condition nor control. Such an attempted exaction falls squarely within the prohibition of the Fourteenth Amendment to the Constitution of the United States.

II.

The Privilege Dividend Tax Act, and assessments here challenged, if valid at all, are nevertheless fatally retroactive and operate to take property without due process contrary to the Fourteenth Amendment.

Even should the Privilege Dividend Tax Act be otherwise sustained, the Act and the taxes here challenged are fatally retroactive and hence violate the due process provisions of the Fourteenth Amendment to the Federal Constitution. This point has not heretofore been submitted to or passed upon by this Court.

As will be pointed out further, the Wisconsin Supreme Court, in its decision in the instant case, disclosed that on this issue in the case before them there was an even division among the six Justices who participated in the decision, one Justice not sitting.

The record shows that the Act was to "take effect on passage and publication, on September 26, 1935." (Ex. 6. R. 18) The record shows that there had been an accumulation of Appellant's so-called surplus from Wisconsin earnings going back at least to 1931; that preceding the date of enactment of the law this accumulated surplus amounted to $803,780.72, and that by December 31, 1935, following the enactment, it had increased to $2,227,493.03 (Ex. 7a. R. 34). It follows that Appellant's surplus of $803,780.72, plus so much of the 1935 increase of $1,423,718.31 as had been accumulated before September 26,

1935, was surplus accumulated prior to the enactment of the Wisconsin Privilege Dividend Tax Law. It is undisputed that the Wisconsin Department of Taxation included in the total "Wisconsin surplus" on which the challenged tax was calculated, all of that surplus accumulated over the years preceding the enactment of the law.

The question is, therefore, squarely presented whether it is possible within the principles of due process under the Federal Constitution, to sustain the Act in question as imposing a tax upon dividends declared and paid subsequent to the enactment of the law, but from income accumulated by Appellant over an indefinitely long period prior to the enactment.

The answer to this question depends upon the determination as to the basis of the tax, whether grounded upon the privilege granted by the state to the corporation of carrying on business in the state, or whether based solely upon the privilege of declaring and receiving dividends. In answering this question it is not enough to look at the simple transaction of declaring and receiving dividends, though that is the transaction described in the Act. If the law is to be sustained at all against foreign corporations and their non-resident stockholders it must be upon some broader basis than the transaction so simply stated. It becomes necessary, therefore, to look to whatever foundation has been shoved under the tax structure to support its constitutionality, however unstable and anomalous that support may be. The only grounds thus far suggested to sustain the tax against foreign corporations and their non-resident stockholders is the privilege granted by Wisconsin to such foreign corporation to transact business and derive income in the state. That privilege, this Court said in *Wisconsin v. J. C. Penney Co.*, 311 U. S. 435; 85 L. Ed. 267, is the privilege to which the tax bears the requisite fiscal relationship. It is to be specifically noted that such statement by this Court was made before the Wisconsin Supreme Court had finally and authorita-

tively determined that the tax is a privilege tax imposed on the stockholder in contrast to an income tax against the corporation. *Blied v. Wisconsin Foundry & Machine Co.*, 243 Wis. 221, 10 N. W. (2d) 142; *Wisconsin Gas & Electric Co. v. Department of Taxation*, 243 Wis. 216; 10 N. W. (2d) 140.

Looking, therefore, to the question of permissible retroactivity of the tax and assuming for the argument that the law is otherwise valid, we find the justification for the tax stated by the Wisconsin Supreme Court thus:

> "We adhere to our determination upon remand of the *Penney Case* that this is a privilege tax and that we are bound to accept the mandate of the United States supreme court that its constitutional justification from the standpoint of Wisconsin's power to tax is the fact of net earnings in Wisconsin traceable to the fund distributed by the dividend." (243 Wis. 198, 206; 10 N. W. 2d, 169, 172)

Though feeling itself compelled to accept the mandate of this Court as to Wisconsin's power to impose the tax in question, the Wisconsin Supreme Court nevertheless in its decision in the instant case pointed out that this Court had reduced the privilege of declaring and receiving dividends "to mere conditions or contingencies, on the happening of which the tax accrues." (243 Wis. 206) In considering the retroactive effect of the tax law regard must be had to the "jurisdictional fact", or "basis of Wisconsin's power to tax", rather than to the "mere conditions or contingencies" upon which the tax may accrue,—the more so since such "mere conditions or contingencies", being the declaration and receipt of the dividends, occurred entirely outside the state of Wisconsin.

If Wisconsin's power to impose a tax upon the non-resident stockholder of a foreign corporation is to be justified by the privilege granted by the state to that corporation to earn income within the state, then under the decisions of this Court as to the per-

missible retroactivity of new tax laws the thrust of the tax cannot reach income earned by the corporation prior to the date of enactment of the law. In *Welch v. Henry*, 305 U. S. 134; 83 L. Ed. 87, this Court affirmed the Wisconsin court in sustaining application of the Wisconsin income tax retroactively to "recent transactions", i.e., dividends received in a prior year. Against the the objection that the tax because retroactive was a denial of due process, this Court in that case (page 147), said:

> "In the cases in which this Court has held invalid the taxation of gifts made and completely vested before the enactment of the taxing statute, decision was rested on the ground that the nature or amount of the tax could not reasonably have been anticipated by the taxpayer at the time of the particular voluntary act which the statute later made the taxable event. * * * Since, in each of these cases, the donor might freely have chosen to give or not to give, the taxation, after the choice was made, of a gift which he might well have refrained from making had he anticipated the tax, was thought to be so arbitrary and oppressive as to be a denial of due process."

Upon the issue of permissible retroactivity of the tax the Wisconsin court, in the instant case, was evenly divided, and the tax assessment against Appellant was accordingly affirmed. On behalf of the three Justices who would limit the retroactive operation of the law it was said:

> "(1) that since the United States Supreme Court has held that the label placed upon this law by the legislature or by this court is wholly ineffective to impair its constitutionality as against the contention that Wisconsin is without power to levy the tax, such label or designation or the selection by Wisconsin of the payment and receipt of the dividend as the occasion for the tax, is equally ineffective to save it from objections to its retroactivity; (2) that the earnings of the corporation in Wisconsin upon which are grounded Wis-

consin's power to levy the dividend tax must be within reach of a retroactive tax; (3) that the extent of permissible retroactivity should be determined upon the analogy of the income tax cases; (4) that retroactivity should only be permitted to 'recent transactions'; (5) that consistently with these principles the tax may not be applied to earnings in Wisconsin which accrued prior to the last corporate fiscal year preceding the enactment of Wisconsin privilege dividend tax; (6) that by reason of the severability clause, the operation of the tax should be so limited; (7) that nothing in the decision upon remand requires a different conclusion." (P. 208)

Even the retroactivity which would have been permitted by the members of the Wisconsin court whose views are quoted above, would be condemned as arbitrary and lacking due process under the tests laid down by this Court. (See *Welch v. Henry, supra*) This for the reason that for the Wisconsin privilege dividend tax there was no precedent in Wisconsin law, nor, so far as we are aware, in the laws of any other state. At no time prior to the initiation of the particular legislative process could that tax have been anticipated.

Prior to 1935, while Appellant was exercising the privilege of doing business in Wisconsin and accumulating the surplus from which the dividends in question were later paid there was no intimation of a tax to be imposed *generally* upon residents and non-residents alike upon the *distribution* of Wisconsin income. There was indeed, overwhelming precedent in the decisions of the Wisconsin Supreme Court that such a tax could not constitutionally be imposed. (*Newport Co. v. Tax Comm.*, 219 Wis. 293; 261 N. W. 884; *State ex rel. Manitowoc Gas Co. v. Tax Comm.*, 161 Wis. 111; 152 N. W. 848)

Mr. Justice Roberts, in the *Penney case*, filed a dissenting opinion in which Mr. Chief Justice Hughes, Mr. Justice McReynolds and Mr. Justice Reed concurred. It was there said:

> "I assume also that, where a state has, by law, fixed the conditions upon which a corporate citizen of another state may enter to transact business, she may not thereafter extend her sovereignty to matters not within her competence, in the guise of annexing other and further conditions or burdens upon the transaction of the corporation's business within her borders." **(Pages 446–447)**

In *Connecticut General Life Insurance Company v. Johnson*, 303 U. S. 77, 79, 82 L. Ed. 673, 677, this Court said:

> "A corporation which is allowed to come into a state and there carry on its business may claim, as an individual may claim, the protection of the Fourteenth Amendment against a subsequent application to it of state law. *Hanover F. Ins. Co. v. Harding* (Hanover F. Ins. Co. v. Carr), 272 U. S. 494, 71 L. Ed. 372, 47 S. Ct. 179, 49 A. L. R. 713; compare *Kentucky Finance Corp. v. Paramount Auto Exch. Corp.*, 262 U. S. 544, 67 L. Ed. 1112, 43 S. Ct. 636."

For the privilege of doing business, granted by Wisconsin to Appellant for the years prior to enactment of the dividend tax, Appellant had met all conditions exacted by the state. The privilege had ripened into vested rights, since the income derived from Wisconsin business, completely discharged from all income taxes, or other charges or restrictions, had been reduced to capital, had been sent outside of Wisconsin, and had become an indistinguishable part of Appellant's funds held beyond the borders of Wisconsin. Such fruits of the privilege granted by Wisconsin were protected from further legislative encroachment. Appropriate to this situation is the following language quoted by this Court in *Coolidge v. Long*, 282 U. S. 582, 603; 75 L. Ed. 562, 570, taken from *Re Craig*, 97 Appellate Division, 289, affirmed 181 N. Y. 551; 74 N. E. 1116:

> "But when the privilege has ripened into a right it is too late to impose conditions of the character in question, and

when the right is conferred by a lawfully executed grant or contract it is property and not privilege, and as such is protected from legislative encroachment by constitutional guaranties."

We submit that, even were the Privilege Dividend tax otherwise valid, it must be held fatally retroactive and violative of due process insofar as it purports to reach income accumulated prior to the enactment of the law albeit distributed by a dividend declared and paid subsequent to the enactment.

III.

The formula under which the Wisconsin privilege dividend taxes are imposed on Appellant is a formula not authorized by the statute, and taxes imposed under such a formula deny due process of law under the Fourteenth Amendment.

This issue has not been before this Court hitherto in its consideration of the Wisconsin Privilege Dividend Tax. Briefly, the issue is whether the assessment made by the Wisconsin Department of Taxation on a formula not provided for by the Wisconsin Privilege Dividend Tax Act denies due process of law under the Fourteenth Amendment to the Federal Constitution.

The Wisconsin Privilege Dividend Tax Act (Sec. 4) provides that the proportion of each dividend allocated to Wisconsin shall be ascertained "in accordance with the provisions of Chapter 71." Chapter 71 is the general income tax chapter. The Wisconsin Privilege Dividend Tax Act adds that in the absence of proof to the contrary the "dividends shall be presumed to have been paid out of earnings of such corporation attributable to Wisconsin under the provisions of Chapter 71, for the year immediately preceding the payment of such dividend."

The pertinent provisions of Chapter 71, being Sec. 71.02 (3) (d) Wis. Stats. are set forth in Appendix B page 54 hereof.

Chapter 71 (the general income tax chapter) provides that in the case of a corporation doing business within and without Wisconsin there shall first be deducted non-apportionable income and that the remaining, or apportionable income, shall be allocated to Wisconsin on the average of three ratios: The ratio of tangible property in Wisconsin to total tangible property, the ratio of sales in Wisconsin to total sales, and the ratio of cost of manufacturing in Wisconsin to total cost of manufacturing.

It is provided that if the use of any one ratio gives an unreasonable or inequitable final average ratio that ratio may be omitted.

This average ratio under the income tax computation is applied to the apportionable net income.

In the privilege dividend tax assessment involved in this appeal the above income tax fraction has been applied by the Wisconsin Department of Taxation to ascertain the portion of the book income each year derived from Wisconsin. (R. 10, 13, 14) That is all it is used for. It is dropped out of the computation from that point on. The Wisconsin Department of Taxation proceeded to accumulate such book income derived from Wisconsin from year to year. It called the accumulated amount Wisconsin income reflected in surplus.

When a dividend was paid the Department divided Wisconsin income reflected in surplus by total surplus and multiplied the total dividend paid by this fraction. The result obtained was the amount of the dividend attributed to Wisconsin, which was taxed at the regular dividend tax rate.

It will be seen how far distant this process is from ascertaining the amount of the dividend derived from Wisconsin under the provisions of Chapter 71, the Income Tax Chapter.

In the first place the income tax formula is used only to determine the proportion of book income in the current year derived from Wisconsin.

In the income tax calculation the income tax fraction is applied against taxable net income, not book net income.

Taxable net income is a very different figure from book net income. For one thing, reserves are deducted in arriving at book net income, but not in arriving at taxable net income.

Wisconsin earnings reflected in surplus is neither an income tax figure nor a book figure. It is a figure resulting wholly from a computation made by the Wisconsin Department. It is utterly unknown to Chapter 71, the Income Tax Chapter; it is utterly unknown to the Wisconsin Privilege Dividend Tax Act.

Total surplus is a book figure which is not used in the income tax computation.

Wisconsin earnings reflected in surplus divided by total surplus is a fraction utterly unknown to the Income Tax Chapter and to the Wisconsin Privilege Dividend Tax Act.

For detailed computation of tax see Exhibit 7a, R. 33–36.

It is significant, we submit, that the Wisconsin Privilege Dividend Tax Act (Sec. 4) provides that if a corporation had a loss for the year prior to the payment of the dividend the Department of Taxation "shall upon application" determine the portion of the dividend "paid out of corporate surplus and undivided profits derived from business transacted and property located within the state." Obviously the application referred to is that of a taxpayer. But there is no such provision for determining the portion of the dividend paid out of surplus except in the case of a loss and then only in the case of an application by the taxpayer. In the case of a corporation which did not have a loss the ascertainment must be made according to Chapter 71, the Income Tax Chapter. The record shows in this case that there was no loss by the Appellant in any of the years involved. (Exhibit 7a, R. 34, 36)

There is no alternative formula provided for in the Income Tax Chapter. The only modification of the income tax formula that may be made is, as we have seen, that one of the three ratios may be dropped out. But there is no provision for substituting a new ratio in place of the one dropped out, much less for substituting an entirely new formula.

Neither is there an alternative formula provided for in the Wisconsin Privilege Dividend Tax statute.

It is obvious that the formula adopted by the Wisconsin Department of Taxation is wholly unknown to the income tax statute and is wholly unknown to the Wisconsin Privilege Dividend Tax statute.

The above explanation and the testimony of Herbert D. Kuentz, Chief Accountant of the Department (R. 9–14 and R. 16–17) show not only the extremely complicated character of the Wisconsin Department of Taxation's formula on which Appellant's taxes have been assessed, but how many assumptions have been made in carrying out that formula and, above all, how radically different the Wisconsin Department's formula is from the simple income tax formula provided in the statute.

We submit, therefore, that the Wisconsin Department of Taxation has ascertained the amount of the dividends taxed in this case by a process wholly unauthorized either by the Wisconsin privilege dividend tax act or the Wisconsin income tax law.

In the case of *Davis v. Wallace,* 257 U. S. 478, 485; 66 L. Ed. 325, 329, the United States Supreme Court said that where the formula provided for by the statute could not be constitutionally applied the taxing officers were not "at liberty to assess it on another and different basis which the statute shows was not to be applied to corporations in a class to which these railroad companies belong." It added, "Of course we cannot so hold."

Likewise, in *Oklahoma v. Wells Fargo Company,* 223 U. S. 298; 56 L. Ed. 445, a case in which the statutory formula could

not constitutionally be applied, Mr. Justice Holmes, writing the opinion, declared that "Neither the court below nor this Court can reshape the statute simply because it embraces elements that it might have reached had it been drawn with a different measure and intent."

In *Commonwealth v. P. Lorillard Co.*, 105 S. E. 683, 685, the Supreme Court of Appeals of Virginia cited with approval the case of *Oklahoma v. Wells Fargo Co.*, *supra*, and stated that the taxing power:

> "is exerted through the legislature, and an executive officer who seeks to enforce a tax must always be able to put his finger upon the statute which confers such authority. Taxes can only be assessed, levied and collected in the manner prescribed by express statutory authority. Tax assessors have no power to make an assessment except in the manner prescribed by law, and if the statute prescribes a method of assessment which is invalid, the assessor has no power or authority to adopt a method of his own which would have been legal if it had been prescribed by the legislature."

It went on to say "The statute conferred no such authority on them (the taxing officers) and they had no such power", namely, no power to "devise a scheme of their own by which to determine how much of the total income of the defendant in error was derived from business done in this state." It held that "the Legislature alone could exercise this power, and, having failed to do so, no such apportionment can be made. * * *"

In *Dravo Contracting Company v. James*, 114 Fed. (2d), 242 (C. C. A. Fourth Cir.), there was involved a West Virginia gross income tax applying in that case to a contractor constructing locks and dams in West Virginia under a contract with the Federal Government. The court said that it agreed with the taxpayer

> "that the court was without power to apportion its (the taxpayer's) income on the basis of the cost of the activities

involved in earning the income within and without the state. No such basis of apportionment is prescribed by statute; and, in the absence of statute, the court is without power to adopt it, as this is a legislative function involved in the imposition of the tax, and therefore not one which courts may exercise."

This Court denied certiorari in this case. (312 U. S. 678; rehearing denied 312 U. S. 714)

See also:

Fisher v. Standard Oil Co., 12 Fed. 2d, 744, 747.
Ford Motor Co. v. State, 258 N. W. 596, 603. (N. Dak.)

It is true that in the case at bar the Wisconsin Supreme Court has approved the formula applied in computing appellant's taxes. But the Wisconsin Supreme Court has no more power to evolve a formula not authorized by the statute than the Wisconsin Department of Taxation has. (*Oklahoma v. Wells Fargo Co.*, also *Dravo Contracting Co. v. James*, quoted above)

This Court has emphatically held that a formula which allocates an arbitrary or excessive portion of capital stock value or of net income to the taxing state is a denial of due process of law. This was held as to a state income tax in *Hans Rees' Sons v. N. Carolina*, 283, U. S. 123; 75 L. Ed. 879.

As a formula allocating an excessive amount of income or of capital stock value is a denial of due process of law, a fortiori the allocation of an amount of dividend derived from Wisconsin under a formula wholly unauthorized by law is a denial of due process. The very essence of due process is taxation according to constituted authority granted by state and a tax levied on a basis devised by taxing officers without any authority by statute whatever would seem necessarily to be a denial of due process of law.

Conclusion

We submit, therefore, in conclusion that testing the Wisconsin Privilege Dividend Tax as applied to dividends paid by the International Harvester Company, not by the name or label which the Wisconsin Supreme Court had given the tax, but by its actual operation and incidence, the tax can no longer be considered an income tax either on the corporation or on the stockholder.

The tax so far as the corporation is concerned, is not on income received by it. The Wisconsin Supreme Court has held that the income tax can only be on income received. The tax may not be deducted by the corporation as a business expense on its Wisconsin income tax return. The tax must be withheld from the dividends, both common and preferred dividends. The burden of the tax is placed directly and unmistakably on the stockholder.

The tax is not computed on the income tax formula.

The tax therefore in the situation presented to this Court bears no resemblance to an income tax on the corporation.

The tax would not be constitutional as an income tax on non-resident stockholders.

The privileges of declaring and receiving dividends are not exercised in Wisconsin, and therefore a tax laid on the exercise of those privileges is a denial of due process of law.

Even on the theory that the tax is, on income derived from Wisconsin, it would be invalid as applied to the distribution of income derived from Wisconsin prior to the enactment of the Wisconsin Privilege Dividend Tax Act.

Finally, the imposition of the tax on the basis of a formula not authorized by this statute but devised by the Wisconsin Department of Taxation to meet the exigencies of a situation where the dividends are paid out of surplus, is a denial of due process of law.

We do not present the following consideration as an argument on the constitutionality of the tax, as applied to the Appellant. But we submit that it is pertinent and proper in order to show what is involved in this appeal.

There is involved in the appeal more than the taxes paid by the Appellant in the period covered by this appeal. These taxes were paid before the decision of this Court in the *Penney case*, and the tax was not withheld from the dividends. Since then, as we have seen, the Wisconsin Supreme Court has held that the tax must be withheld from the dividends and may not be absorbed as a business expense by the corporation and deducted on its Wisconsin income tax return. There is also involved on this appeal, therefore, the question of withholding the tax in the future.

The tax in 1937, for example, on a quarterly common stock dividend in 1937 of $.625 per share would have been only $.01625 on twenty shares. (Namely, 2.5% tax on 5.8% of $12.50. R. 21, 33.) On ten shares it would have been only $.008125. On ten shares of preferred stock it would have been $.02503. There were 32,000 stockholders. (R. 36) It is obvious that this calculation would have to be made four times a year for each quarterly dividend of each stockholder. If each common stockholder were also a preferred stockholder, then the calculation would have to be made four times a year for the common stock dividends and four times a year for the preferred stock dividends, for each stockholder, or in other words, 256,000 calculations a year. This is the maximum number of calculations that would be required. To the extent that some of the stockholders held only one class of stock, the number of calculations would be proportionately decreased. For example, if 16,000 stockholders owned only common stock, and 16,000 stockholders owned only preferred stock, there would be 128,000 calculations annually. This would be the minimum number of calculations involved. It is surely inevitable that

a stockholder in Maine or California who received a dividend check with a deduction of $.01625 for the Wisconsin privilege dividend tax would wonder why he should be assessed such an amount for a tax in Wisconsin. The calculation of this tax a minimum number of 126,000 times a year would not only be costly and burdensome, but the annoyance and irritation caused its stockholders from Maine to California and in foreign countries, would be a legitimate matter of concern to any corporation desirous of retaining the good will of its stockholders.

Moreover, if this tax should be held a valid exercise of the taxing power of Wisconsin, and thereupon as many as twenty states should adopt a similar tax, it will readily be seen that the number of calculations required of this Appellant would be a minimum of 2,560,000 a year, and the danger of loss of stockholder good will that much intensified.

The law we submit has become a nuisance tax.

Respectfully submitted,

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APPENDIX "A"

The pertinent provisions of the Wisconsin Privilege Dividend Tax Act, being Section 3 of Chapter 505, Laws of 1935, as amended by Chapter 552, Laws of 1935, and Chapters 233 and 309, Laws of 1937; Published and effective September 26, 1935:

"Section 3. PRIVILEGE DIVIDEND TAX. (1) For the privilege of declaring and receiving dividends, out of income derived from property located and business transacted in this state, there is hereby imposed a tax equal to 2½ per cent of the amount of such dividends declared and paid by all corporations (foreign and local), except those specified in paragraphs (d) and (g) of subsection (1) of section 71.05 of the statutes, after the passage and publication of this act and prior to July 1, 1939. Such tax shall be deducted and withheld from such dividends payable to residents and nonresidents by the payor corporation.

(2) Every corporation required to deduct and withhold any tax under this section shall, on or before the last day of the month following the payment of the dividend, make return thereof and pay the tax to the tax commission, reporting such tax on the forms to be prescribed by the tax commission.

(3) Every such corporation hereby made liable for such tax, shall deduct the amount of such tax from the dividends so declared.

(4) In the case of corporations doing business within and without the state of Wisconsin, such tax shall apply only to dividends declared and paid out of income derived from business transacted and property located within the state of Wisconsin. The amount of income attributable to this state shall be computed in accordance with the provisions of chapter 71. In the absence of proof to the contrary, such dividends shall be presumed to have been paid

out of earnings of such corporation attributable to Wisconsin under the provisions of Chapter 71, for the year immediately preceding the payment of such dividend. If a corporation had a loss for the year prior to the payment of the dividend, the tax commission shall upon application, determine the portion of such dividend paid out of corporate surplus and undivided profits derived from business transacted and property located within the state.

* * *

(7) For the purposes of this section dividends shall be defined as in section 71.02, except that the tax herein imposed shall not apply to stock dividend or liquidating dividends.

(8) The tax hereby levied, if not paid within the time herein provided, shall become delinquent and when delinquent shall be subject to a penalty of two per cent on the amount of the tax and interest at the rate of one-half per cent per month until paid.

* * *

(10) Except as they are inconsistent with this section, the provisions of paragraph (b) of subsection (3) of section 71.06, sections 71.10 to 71.17, inclusive, subsection (3) of section 71.18, sections 71.36 and 71.37 of the statutes shall apply to the tax imposed by this section, but the discount provisions of paragraph (c) of subsection (3) of section 71.10 shall not apply."

APPENDIX "B"

Pertinent provisions of Wisconsin Income Tax Chapter, Section 71.02 (3) (d), Wisconsin Statutes:

"(d) Persons engaged in business within and without the state shall be taxed only on such income as is derived from business transacted and property located within the state. The amount of such income apportionable to Wisconsin may be determined by an allocation and separate accounting thereof, when, in the judgment of the department of taxation, that method will reasonably reflect the income properly assignable to this state, but otherwise in the following manner: There shall first be deducted from the total net income of the taxpayer such part thereof (less related expenses, if any) as follows the situs of the property or the residence of the recipient; provided, that in the case of income which follows the residence of the recipient, the amount of interest and dividends deductible under this provision shall be limited to the total interest and dividends received which are in excess of the total interest (or related expenses, if any) paid and allowable as a deduction under section 71.03 during the income year. The remaining net income shall be apportioned to Wisconsin on the basis of the ratio obtained by taking the arithmetical average of the following three ratios:

1. The ratio of the tangible property, real, personal, and mixed, owned and used by the taxpayer in Wisconsin in connection with his trade or business during the income year to the total of such property of the taxpayer owned and used by him in connection with his trade or business everywhere. Cash on hand or in bank, shares of stock, notes, bonds, accounts receivable, or other evidence of indebtedness, special privileges, franchises, good will, or property the income of which is not taxable or is separately allocated, shall not be

considered tangible property nor included in the apportionment.

2. In the case of persons engaged in manufacturing or in any form of collecting, assembling, or processing goods and materials within this state, the ratio of the total cost of manufacturing, collecting, assembling, or processing within this state to the total cost of manufacturing, or assembling, or processing everywhere. The term 'cost of manufacturing, collecting, assembling, or processing within this state and everywhere,' as used herein, shall be interpreted in a manner to conform as nearly as may be to the best accounting practice in the trade or business. Unless in the opinion of the department of taxation the peculiar circumstances in any case justifies a different treatment, this term shall be generally interpreted to include as elements of cost within this state the following:

a. The total cost of all goods, materials, and supplies used in manufacturing, assembling, or processing within this state regardless of where purchased.

b. The total wages and salaries paid or incurred during the income year in this state in such manufacturing, assembling, or processing activities.

c. The total overhead or manufacturing burden properly assignable according to good accounting practice to such manufacturing, assembling, or processing activities within this state.

3. In the case of trading, mercantile or manufacturing concerns the ratio of the total sales made through or by offices, agencies, or branches located in Wisconsin during the income year to the total net sales made everywhere during said income year.

4. Where, in the case of any person engaged in business within and without the state of Wisconsin and entitled to an apportionment of his income as herein provided, it shall be shown, to the satisfaction of the department of taxation, that the use of any one of the three ratios above provided for gives an unreasonable or inequitable final average ratio

because of the fact that such person does not employ, to any appreciable extent in his trade or business in producing the income taxed, the factors made use of in obtaining such ratio, this ratio may, with the approval of the department of taxation, be omitted in obtaining the final average ratio which is to be applied to the remaining net income."